Supreme Court, U.S.
FILED
JAN 15 1993
OFFICE OF THE CLERK

No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF AMICUS CURIAE OF HAROLD J. BARKLEY, JR. IN SUPPORT OF PETITIONERS

HAROLD J. BARKLEY, JR.
Counsel of Record

TERRE M. VARDAMAN
Of Counsel

5015 I-55 N. Frontage Road
P.O. Box 55849
Jackson, MS 39296-5849
601/981-7800

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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INTEREST OF THE AMICUS

The Amicus, Harold J. Barkley, Jr., is the Standing Chapter 13 Trustee for the Southern District of Mississippi, Jackson Division. This Trustee respectfully submits this Brief Amicus Curiae in support of the Petitioner.

In a bankruptcy situation, the value of a homestead is usually closely related to the amount of the debt securing the first deed of trust on the homestead. In practice or reality, in addition to the first deed of trust, it is becoming increasingly common in states where permitted by law for a lender (loan company) or a consumer creditor (short term finance companies) to advance money to a debtor in an amount that exceeds the value of the homestead and taking a second deed of trust on the homestead for this

additional sum of money. Furthermore, it is not uncommon for a third lender or consumer creditor to advance money in an amount that further exceeds the value of the homestead in return for a third deed of trust on the homestead. The purpose of these additional loans are many times wholly unrelated to either the purchase of the home or home improvement.

The monthly payment secured by the first deed of trust is usually small enough that the debtor can maintain that payment; however, after adding the monthly payments on the debts secured by the second and third deed of trust, the debt becomes burdensome or impossible for the debtor to pay. The *Nobelman* decision has effectively prohibited lien stripping in the Fifth Circuit. After *Nobelman* an undersecured creditor who holds a valueless lien may receive a greater distribution in a Chapter 13 plan than general unsecured creditors and certainly more than that same undersecured creditor would receive in a foreclosure situation. It is inequitable that a debtor should lose his major asset, his home, because of the inability to maintain payments on a loan not supported by value.

SUMMARY OF ARGUMENT

Presently in Mississippi there is one reported case on the issue before this Court[1] – may a debtor's Chapter 13 plan employ 11 U.S.C. 506 to bifurcate a mortgage lien claim on debtor's principal residence into an allowed

[1] *Franklin v. Union Mortgage Co. (In re Franklin)*, 126 B.R. 702 (Bankr. N.D. Miss. 1991).

secured and an allowed unsecured portion of the claim? The *Nobelman* decision has overruled the holding of *Franklin*.

By allowing the debtors to bifurcate the mortgage lien claim pursuant to 11 U.S.C. 506 and then prohibiting a modification of the secured claim as contemplated by 11 U.S.C. 1322(b)(2), the Bankruptcy Code is applied systematically and coherently rather than a finding of conflict of Code sections or a disregard of certain sections of the Code. To prohibit bifurcation of a claim is to find a conflict between 11 U.S.C. 506 and 11 U.S.C. 1322(b)(2), and 11 U.S.C. 103(a) is simply ignored if bifurcation is not allowed.

ARGUMENT

Since 1979, numerous lines of cases have evolved concerning the status of home mortgages covered under Section 1322(b)(2). The first line of cases states that while Section 506 applies in cases under Chapters 7, 11, and 13 of the Bankruptcy Code, Section 1322 applies only in Chapter 13 cases and that regardless of the inclusiveness of the general language of the statute, Section 506 will not apply over matters specifically dealt with in another part of the Code. *In re Hynson*, 66 B.R. 246, 249 (Bankr. D.N.J. 1986).

Secondly, a theory was recognized that if any collateral other than the debtor's principal residence secured the loan, then the claim could be modified. *In re Stiles*, 74 B.R. 708 (Bankr. N.D. Ala. 1981) (debts secured by security interest in debtor's credit life policy as well as

debtor's residence could be modified in Chapter 13 plan); *In re Simpkins*, 16 B.R. 956 (Bankr. E.D. Tenn. 1982) (second mortgage note secured by debtor's principal residence and security interest in motor home could be modified); *United Companies Financial Corporation v. Brantley*, 6 B.R. 178 (Bankr. N.D. Fla. 1980) (modification of mortgage note allowed where debt was secured by an assignment of life insurance policy as well as by the mortgages). The courts, in reaching the holdings in the above cited cases, relied on the legislative history and intent of Section 1322(b)(2), which they contended was designed to provide stability in the residential long-term home financing industry and market. There is no question that Congress intended some protection to institutional lenders engaged only in providing long-term home mortgage financing; however, the question is – how much protection did Congress envision? Four Circuit Courts of Appeal have limited the protection to the secured portion of the claim. *See Bellamy v. Federal Home Loan Mortgage Co. (In re Bellamy)*, 962 F.2d 176 (2d Cir. 1992); *Sapos v. Provident Inst. of Sav. In Town of Boston*, 967 F.2d 918 (3d Cir. 1992); *Eastland Mortgage Co. v. Hart (In re Hart)*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Bank*, 895 F.2d 123 (3d Cir. 1990); *Hougland v. The Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1186 (9th Cir. 1989). More recently, the Ninth Circuit reaffirmed the *Hougland* decision in *Lomas Mortgage v. Wiese (In re Wiese)*, Nos. 91-36082, 91-36173, 1992 WL 354917 (9th Cir. Dec. 4, 1992).

The third line of cases allowed modification of a secured mortgage secured only by the debtor's principal residence by first looking to Section 506 to determine

whether a claim was secured and if the claim was not secured under Section 506, then the creditor was not entitled to the protection of Section 1322(b)(2). The court opined that a review of Section 506 indicated a desire on the part of Congress to make certain that creditors claiming to be secured, who, in fact, are not secured, should not enjoy a priority payment status over other unsecured creditors. *In re Bruce*, 40 B.R. 884, 887 (Bankr. W.D. Va. 1984). *See also In re Morphis*, 30 B.R. 589 (Bankr. N.D. Ala. 1983) and *In re Neal*, 10 B.R. 535 (Bankr. S.D. Ohio 1981).

The fourth theory regarding second mortgages specifically says that short-term consumer loan type debts secured by a security interest in the principal residence are not entitled to the protection of Section 1322(b)(2), notwithstanding the fact that the value of the real estate may be high enough to make the debt fully secured. *In re Shaffer*, 84 B.R. 63, 67 (Bankr. W.D. Va. 1988). This theory is not an issue here, but merely offered for the proposition that Section 1322(b)(2) is not inviolate. Of concern here is the rationale of the first and third line of cases regarding the applicability of the statutes. In the first line of cases there is a conflict between Sections 506 and 1322; the third line of cases suggests that Section 506 is a definitional statute and must be used before applying Section 1322(b)(2) to determine the secured portion of the claim.

Clearly there is precedent for this Court to bifurcate the claim of American Savings Bank even though the indebtedness is secured only by the Debtors' homestead. Section 506(a) is a definitional statute, and, further, pursuant to Section 103(a), Chapter 5 applies to Chapter 13 cases. 11 U.S.C. 103(a).

This Court is urged to consider the fresh start aspect mentioned in the *Folendore* case. *Folendore v. U. S. Small Business Admin.* (*Matter of Folendore*), 862 F.2d 1537 (11th Cir. 1989). While realizing a Chapter 7 debtor must redeem "stripped down" claims, certainly the Chapter 13 debtor deserves the same fresh start and should be allowed to void a lien to the extent it is unsecured. The secured claim is not being modified nor crammed down. The terms of the contract remain unaltered and the creditor will receive the same amount as in a foreclosure under state law. Chapter 5 is omnibus, and Section 506 cannot be disregarded in a Chapter 13 case simply because of Section 1322(b)(2). The various sections of the Code are not dichotomous; they should be read together.

While aware of this Court's holding in *In re Dewsnup*, ___ U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), the Court is also urged to follow the rationale of the Second and Third Circuits and limit *Dewsnup* to its particular facts. *In re Bellamy*, 962 F.2d 176 (2d Cir. 1992). *In re Sapos*, 967 F.2d 918 (3d Cir. 1992). Indeed, this Court itself alluded that *Dewsnup* did not apply to all fact situations. 112 S.Ct. at 778. In the only Mississippi Bankruptcy Court decision concerning the issue before this Court, Judge David W. Houston, III found that the "*Dewsnup* rationale results in an unnecessary emasculation of Section 506(d)." *Franklin v. Union Mortgage Co.* (*In re Franklin*), 126 B.R. 702, 710 (Bankr. N.D. Miss. 1991).

Judge Houston succinctly brought the issue of bifurcation in a Chapter 13 case into perspective – "one must hypothetically apply the Chapter 7 *majority* viewpoint, which allows the use of Section 506(d) to avoid undersecured or unsecured liens," to a Chapter 13 scenario.

Franklin at 710. If Chapter 7 debtors may utilize Section 506 to their benefit, then Chapter 13 debtors are penalized by the prohibition of using Section 506. *Id.* The debtors in the *Franklin* case, as well as the Debtors in the case herein, if the Chapter 7 majority viewpoint were applied, could have filed a Chapter 7 and in the *Franklin* case avoided the lien entirely and avoided the lien partially in the case *sub judice*. *Id.* "To say that similar relief should not be available for the debtors in their existing 13 case is illogical." *Id.* (*See also In re Franklin*, 126 B.R. 702, 711-712 (Bankr. N.D. Miss. 1991) for an excellent discussion of how the secured portion of a claim is treated if bifurcation is allowed.)

Further, a determination that Section 506 may be applied in a Chapter 13 case notwithstanding Section 1322(b)(2) does not "undercut the congressional policy of protecting long-term mortgage-backed obligations." *In re Frost*, 96 B.R. 804, 807 (Bankr. S.D. Ohio 1989), *aff'd*, 123 B.R. 254 (S.D. Ohio 1990). The mortgagee has the control regarding the ratio of value to loan amount. Absent unforeseen circumstances, the first mortgage holder is usually fully secured. *Id.* All one has to do to be aware of the recession in this country and the poor economy is glance at the front page of any newspaper on any given day. This writer submits that this unforeseen or unexpected bottoming out of the economy affects debtors and creditors alike. It is an unhappy and frightening situation. But to force a debtor to pay $70,000.00 for a home worth $23,500.00 is not the answer.

Individuals in Texas are afforded a great deal of "homestead" protection by the Texas Constitution[2] and codified by statute.[3] Only a purchase money lien or a lien

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[2] **Homestead; protection from forced sale; mortgages, trust deeds and liens**

Sec.50. The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for the purchase money thereof, or a part of such purchase money, the taxes due thereon, or for work and material used in constructing improvements thereon, and in this last case only when the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sale and conveyance of the homestead; nor may the owner or claimant of the property claimed as homestead, if married, sell or abandon the homestead without the consent of the other spouse, given in such manner as may be prescribed by law. No mortgage, trust deed, or other lien on the homestead shall ever be valid, except for the purchase money therefor, or improvements made thereon, as hereinbefore provided, whether such mortgage, or trust deed, or other lien, shall have been created by the owner alone, or together with his or her spouse, in case the owner is married. All pretended sales of the homestead involving any condition of defeasance shall be void. This amendment shall become effective upon its adoption. Amended No. 6, 1973.

Tex. Const. art. 16, § 50.

[3] **41.001. Interests in Land Exempt from Seizure**

(a) A homestead and one or more lots used for a place of burial of the dead are exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property.

(b) Encumbrances may be properly fixed on homestead property for:

(1) purchase money;

(2) taxes on the property; or

(3) work and material used in constructing improvements on the property if contracted for in writing before the

for home improvement may encumber a Texas homestead. However, in Mississippi there is no such protection. There is no limit to the number and types of liens that may be secured by the homestead. Certainly it is poor judgment to encumber one's home with such liens, but there has never been a truer statement than "hindsight is 20/20." It is also important to note than many times the debtor does not possess either an equal bargaining position with the lender or a full understanding of the documents which are required to be executed in order to obtain the loan. Additionally, the economic status of the debtor leaves him no other option than to bargain away his most valuable and necessary asset.

For a short time, by virtue of the *Franklin* decision, the debtor in Mississippi was able to bifurcate the claim(s) on his homestead and pay only the secured value, and, if all plan payments were completed, he could avoid the unsecured portion of the liens. This avoidance power gave the debtor the fresh start which is the heart of the Bankruptcy Code. *Folendore* at 1540. Further, rather than the debtor receiving a windfall, Section 506 "permits the debtor to eventually repurchase an equity interest" in the property. *Id.* The *Nobelman* decision has effectively halted lien stripping in Mississippi, leaving the debtors

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material is furnished or the labor is performed and in a manner required for the conveyance of a homestead, with joinder of both spouses if the homestead claimant is married.

(c) the homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.

Tex. Prop. Code, § 41.001 (1991).

with no relief or remedy available to retain their home encumbered by valueless liens.

Consider a hypothetical debtor in Mississippi whose home is encumbered by three liens – not an unusual fact pattern. With the residence having an uncontroverted value of $25,000.00, the first lien is purchase money and is fully secured with an indebtedness of $20,000.00. The second lien holder has a claim for $15,000.00 and the third a claim of $10,000.00. The debtor cannot use the cram down provision of the Bankruptcy Code, 11 U.S.C. 1322(b)(2), as the liens are secured only by the debtor's homestead. Therefore, the debtor, prior to the *Franklin* case, and now subsequent to *Nobelman*, had or has to maintain three mortgage payments and cure the mortgage payment arrears on three mortgages as a minimum requirement for plan confirmation. If *Nobelman* is allowed to stand, the prudent short-term lender would forego any security interest in personal property, preferring instead to obtain a deed of trust on the debtor's homestead regardless of value underlying the lien. This deed of trust provides the lender with an unalterable security position on the debtor's homestead. The creditor would be entitled to have its claim paid in full, thus insuring a greater protection in bankruptcy than afforded under Mississippi debtor-creditor law. The debtor is defeated before being afforded the fresh start supposedly provided by the Bankruptcy Code. The plan has a much higher rate of success if the debtor can avoid the liens not supported by actual value of the collateral. He must maintain and cure the arrearage of the first mortgage and is able to partially strip the lien of the second mortgage and fully avoid the third lien, treating these claims as all other unsecured

claims. Although the success of the debtor's financial rehabilitation is not assured, the debtor's chances are greatly improved.

In many rural states such as Mississippi, the first lienholder in numerous instances is the Farmers Home Administration. Because of the debtor's inability to service a second and/or third mortgage payment, the home is foreclosed upon after the automatic stay has been lifted in the bankruptcy case. Unless the first lienholder (FmHA) is paid off by the foreclosing second or third mortgagee, the property is placed into the already excessive inventory of property held by government agencies. The same result occurs if FmHA forecloses. An analogous situation arises when dealing with the Federal Housing Administration loans on real property when the United States government is required to honor its guaranty.

Since the Chapter 13 Trustee is under a duty to ascertain that all disposable income is disbursed to unsecured creditors, if the lien stripping is allowed, there is a greater likelihood of more disposable income for all creditors of the bankrupt estate. Instead of a creditor who in reality is unsecured but for the "valueless" lien, the monies proposed to this creditor should be paid to all unsecured creditors.

The Trustee urges this Court to recognize that the facts of *Nobelman* are atypical. In *Nobelman*, the creditor became undersecured as a result of the bottoming out of the economy in Texas. However, this Trustee would suggest that the majority of cases where lien stripping is an issue involve liens held by short-term consumer creditors who advanced monies in return for a junior lien position

with no investigation of property value and no real reliance on the value of the collateral to satisfy the lien. Certainly the same consumer creditor would receive nothing or very little as a result of a foreclosure sale under state law. Therefore, it appears inequitable that such a creditor would receive more in a chapter 13 case than other general unsecured creditors of the estate by simply being in a position to insist on a valueless deed of trust. To allow *Nobelman* to stand is to deny innumerable debtors the avenue of relief intended to be afforded by Chapter 13 of the Bankruptcy Code.

CONCLUSION

The Court should reverse the decision below and allow bifurcation of a claim secured only by the Debtors' principal residence into allowed secured and unsecured claims by applying all the Bankruptcy Code sections in an orderly fashion. There is simply no logical explanation to ignore Sections 103(a) and 506 of the Code in a Chapter 13 case.

Respectfully submitted,

HAROLD J. BARKLEY, JR.
Counsel of Record

TERRE M. VARDAMAN
Of Counsel

5015 I-55 N. Frontage Rd.
P.O. Box 55849
Jackson, MS 39296-5849
601/981-7800